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C O N F I D E N T I A L SECTION 01 OF 03 DUBLIN 001517

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TAGS: ECON EFIN EINV PREL EI
SUBJECT: BIG HELP FOR WORKING FAMILIES: IRELAND'S 2006 GOVERNMENT BUDGET

Classified By: Ambassador James C. Kenny; Reasons 1.4 (B) and (D).

¶1. (SBU) Summary: On December 7, Finance Minister Brian Cowen unveiled the 2006 Government budget, a televised event that annually serves as Ireland's financial state-of-the-union address and a window on the governing Fianna Fail party's political strategy. With a robust economy and a euro four billion government surplus from 2005, Cowen was well positioned ahead of the 2007 general elections to focus the budget's chief benefits on Fianna Fail's core constituency, middle-class families. The budget provides generous childcare subsidies and lowers taxes for families earning average wages, as part of a package that targets other middle-class concerns, such as the elderly, education, and health. In areas of USG interest, the budget includes a minuscule spending increase for defense and a large jump for the Department of Foreign Affairs, which mostly reflects the Government's attempt to increase overseas aid from 0.4 percent to 0.7 percent of GNP by 2012. While the budget received a mostly favorable public reaction, the U.S. business community opposed the budget's proposal to eliminate tax breaks for foreign executives. The Ambassador is engaged on this proposal with Minister Cowen's personal advisor, who believes that the proposal can be modified. Overall, the budget's structure reflects Fianna Fail's bid to protect its lead in the polls ahead of the 2007 general elections, while being careful not to over-stimulate an already robust economy. End summary.

Background: Spending Increases in a Strong Economy

¶2. (U) On December 7, Finance Minister Brian Cowen unveiled the 2006 Government budget to the Irish Parliament, a televised event that annually serves as Ireland's financial state-of-the-union address and a window on the ruling Fianna Fail party's political strategy. Under the 2006 budget, total government expenditures will increase 11 percent over 2005 to reach euro 50.6 billion, the first time a budget has passed the euro 50 billion threshold. Cowen highlighted the positive macroeconomic backdrop to the budget, as 2005 saw real GDP growth of 4.6 percent and the creation of roughly 96,000 new jobs. For 2006, he projected a government deficit at 0.6 percent of GDP, with public debt at 28 percent of GDP, one of the lowest debt ratios in the EU. (The government deficit he predicted for 2005 turned into a euro 4 billion surplus, thanks mainly to strong revenues from capital gains taxes and stamp duties targeting Ireland's vibrant housing market.)

The Big Winners: Couples with Children

¶3. (U) Whereas the 2005 budget showcased benefits for society's least advantaged, the chief beneficiaries of the 2006 budget will be working households with childcare expenses. The budget features a five-year euro 2.65 billion strategy to address the supply and cost of childcare, including a yearly euro 1,000 supplement for every child up to the age of six. There will also be funding to train 17,000 more childcare personnel by 2010, as well as investment in childcare facilities to accommodate 50,000 more children. To reduce childcare expenses in a child's first year, the Government will extend both paid and unpaid maternity leave to a combined 56 weeks, with Government funding to defray attendant costs for business.

¶4. (U) Tax relief under the 2006 budget will also primarily benefit middle-class families. Most notably, the Government will raise the income threshold at which a standard 42 percent personal tax liability applies, effectively pushing 90,000 people down into the 20 percent tax bracket. Cowen explained that this step would ensure that workers earning the average industrial wage would pay tax at the lower rate. A range of tax benefits will similarly push 52,000 people below the 20 percent tax bracket, out of the tax net. In response to public complaints about millionaires who pay no tax, Cowen also pledged to cap by 2007 the level of tax relief available to those earning over euro 250,000.

Other Categories of Note

¶5. (U) Other budgetary categories of interest are:

A) Education. The budget allocates euro 1.2 billion to help universities build/upgrade their infrastructure and to produce more Ph.D. students through a new Strategic Innovation Fund. (This outlay probably means that university tuition for Irish students will not be reintroduced this decade.)
B) The elderly. Besides providing for weekly increases in state pensions, the budget includes euro 150 million to support the care of elderly at home and nursing facilities. There is also a euro 400 million carve-out to compensate those elderly who have been wrongly charged over two decades for stays in public nursing homes.

C) Health. Nearly one-quarter of total public expenditures, or euro 12.2 billion, will go to the health sector, which remains characterized by hospital queues and other inefficiencies despite significant increases in spending over the past decade.

D) Defense. The budget raises defense spending (exclusive of army pensions) by 2.5 percent to roughly euro 731 million, continuing a trend of relatively minor increases in defense expenditures over recent years. (The Irish military will probably enjoy cost savings over the next three years as it brings home 400 troops participating in the UN Liberia mission.)

E) Foreign Affairs and Aid. Spending on the Department of Foreign Affairs (DFA) will jump 8 percent after a paltry 1.4 percent increase in 2005. The spending ramp-up reflects a 26 percent increase in official development assistance (ODA), following on Prime Minister Bertie Ahern's pledge at the September UN High Level Event to increase ODA from 0.4 percent of GNP to 0.7 percent by 2012.

Overshadowed by a Resignation

¶6. (SBU) Although the Government had expected good publicity for the budget, headlines were partly stolen by the December 8 resignation of Ivor Calley, (Junior) Minister of State for Transportation and Fianna Fail parliamentarian. The Irish press reported on December 7 that a construction company had painted Calley's home for free in the early 1990s, a disclosure that capped several weeks of reports on Calley's questionable ethical actions at the Department of Transport. After his resignation on the morning of December 8, the national radio station, RTE, interviewed Calley in the slot that had been reserved for Minister Cowen's budget briefing, keeping Cowen in the studio wings for a half-hour. Afterward, Calley inexplicably attended a Parliamentary session on the budget in his minister's seat. His presence led opposition leaders to interrupt Prime Minister Ahern repeatedly to demand a statement about the resignation, preempting discussion of the budget for most of the session.

Reaction: Mostly Favorable, but U.S. Firms Protest

¶7. (U) Notwithstanding the Calley story, the budget received a mostly favorable public reaction. Families interviewed by the press expressed enthusiasm for benefits that would reduce the cost of care for children and elders. Economists also generally applauded the budget, though some voiced concern that the budget's benefits package might lend inflationary pressure to an already robust economy. In contrast, other economists noted that higher interest rates, mounting consumer debt, high fuel costs, and a possible housing market slowdown could bite into Cowen's predictions for continued strong economic growth and tax receipts in 2006. As is customary, the political opposition criticized the budget, primarily for not being more generous with social welfare benefits.

¶8. (SBU) The U.S. business community strongly opposed the budget's unexpected proposal to eliminate the remittance basis of personal income taxation for resident foreign executives. Currently, the tax system allows foreign executives in Ireland to receive their salary outside Ireland's jurisdiction and pay tax only on money they "remit," or bring into, the country to support themselves. On December 8, the American Chamber of Commerce issued a statement that the budget proposal would "make Ireland unattractive as a base for these senior executives" and act as a disincentive to foreign investment. The Sunday Business Times also reported that, at a December 8 post-budget brief for the financial industry, U.S. firms heavily lobbied Minister for Enterprise, Trade and Employment Micheal Martin to support the remittance basis for taxation. Business lobbying will likely continue in the run-up to Parliamentary debate in early 2006 on the Finance Bill, where the budget proposal could possibly be inserted.

Cowen's Advisor: U.S. Firms' Input Welcome

¶9. (C) On December 12, the Ambassador discussed the 2006 budget with Alan Gray, Chairman of Indecon, a large economic consultancy, and Minister Cowen's personal advisor on the budget process. The Ambassador cited U.S. business opposition to the tax remittance proposal, and Gray expressed optimism that the proposal could be modified in response to U.S. firms' input. Gray asked the Ambassador to canvass executives with key U.S. IT firms and get back to him (which we plan to do before Christmas). Regarding some economists' warnings that the budget might be inflationary, Gray argued that that the benefits package was generous, but not to the point of inviting price pressures. Even if such pressures did arise, he said, the Government could respond with measures to improve market competition, such as the recent rescission of regulations preventing supermarkets from selling goods at below-invoice prices. Gray, furthermore, confirmed that Government leaders were "fuming" at the timing of Ivor Calley's resignation, which had stepped on a carefully planned choreography to maximize the budget's political punch.

Comment: A Finely Tailored Product

¶10. (SBU) From a political perspective, the 2006 budget hits all the right levers, reflecting the governing Fianna Fail party's bid to lock in its lead position in current polling. Cowen publicly denied that the budget was drafted with the 2007 general elections in mind, but budgetary benefits nevertheless target Fianna Fail's core constituency: middle-class couples with children. In recent press surveys, rising childcare expenses had consistently ranked atop parents' concerns, especially with women entering the work force in droves to help families meet the high cost of living. The budget's generous childcare benefits and tax relief measures should thus improve Fianna Fail's support among working families in the last full year before elections. The budget also catered to another key political demographic, the elderly, who will welcome higher pensions, increased funding for home/hospital care, and compensation for wrongful charges at public nursing homes. Meanwhile, continued increases in other social welfare benefits will enable to Fianna Fail to claim that it remains focused on society's disadvantaged groups, the theme of the 2005 budget.

¶11. (U) Economically, the budget is stimulatory, but prudent. Whereas the benefits package received most attention, the 11 percent increase in government expenditures is similar in size to budget increases in recent years. As one Irish economist observed, the budget benefited everyone, but not dramatically so. One possible reason that the Government chose not to risk over-stimulating the economy with an even more generous budget is the impending maturation of the Special Savings Incentive Accounts (SSIAs). The SSIAs are a nationwide personal 5-year savings scheme launched by the Government in 2001 that will begin in 2006 to put roughly euro 14 billion back in the hands of the accounts' holders -- another nice benefit for prospective voters.
KENNY